



The Impact of Removing the Cliff Effect in Child Allowance in the Czech Republic

Vlastimil Beran¹, Robert Jahoda², Jitka Špeciánová³, Filip Mandys⁴

Abstract

Cliff effects in tax and benefit systems have been the subject of growing scholarly attention for more than three decades. Despite this sustained interest, they continue to persist in the design of many national systems. Empirical studies consistently demonstrate that the presence of cliff effects undermines the economic incentives of individuals and households, especially in relation to the concepts of the “unemployment trap” and “poverty trap”. This article focuses on the analysis of a cliff effect associated with child allowance within the system of state social support. The assessment of the potential impact of removing this cliff effect is based on empirical data from November 2022 and 2023, using simulation and microsimulation methods. The results suggest that the elimination of the cliff effect could significantly enhance work incentives for individuals and households near the eligibility threshold. Moreover, the fiscal impact of such a measure appears to be budget-neutral.

Keywords

Cliff Effect, Eligibility Threshold, Child Allowance, Social Benefit

I. Introduction

The aim of this article is to assess whether the removal of the benefit cliff in the child allowance scheme within the state social support system could incentivize individuals and households to engage more actively in the labour market. The issue must be considered not only from the perspective of benefit recipients themselves but also from that of the state, particularly with regard to the implications for public finances.

¹ Research Institute for Labour and Social Affairs, Jeruzalémská 1283/9, 110 00 Praha, Czech Republic. E-mail: vlastimil.beran@rilsa.cz.

² Research Institute for Labour and Social Affairs, Jeruzalémská 1283/9, 110 00 Praha, Czech Republic. E-mail: robert.jahoda@rilsa.cz.

³ Research Institute for Labour and Social Affairs, Jeruzalémská 1283/9, 110 00 Praha, Czech Republic. E-mail: jitka.specianova@rilsa.cz.

⁴ Research Institute for Labour and Social Affairs, Jeruzalémská 1283/9, 110 00 Praha, Czech Republic. E-mail: filip.mandys@rilsa.cz.

The child allowance is one of five benefits provided under the state social support system. Through these benefits, the state contributes to covering the costs of nutrition and other essential personal needs of children and families, and it is also provided in certain other social circumstances. State social support is granted, in specified cases, on an income-tested basis (Act No. 117/1995 Coll.). Income-tested benefits include the child allowance, the housing allowance, and the birth grant. The child allowance constitutes one of the key forms of financial support for families with children in the Czech social protection system. The eligibility condition for this benefit, determined by a single fixed income threshold, creates what is known as a benefit cliff. In the case of the child allowance, this principle has been applied since 1 January 1996; in its current legislative form, it has been in place since 1 January 2008. This is therefore a mechanism that has influenced the Czech labour market for nearly three decades. Although there is insufficient data to precisely quantify its long-term economic impacts, it can be reasonably assumed that its existence significantly affects the work incentives of households.

The removal of the benefit cliff, planned for 1 October 2025, represents a substantial policy shift. At present, a dependent child is eligible for the child allowance if the household's assessed income does not exceed the product of the household's subsistence minimum and a coefficient of 3.40 (Act No. 117/1995 Coll.). This income limit constitutes the benefit cliff: if the household does not exceed it, they receive the full benefit amount; if they exceed it, entitlement to the benefit is lost entirely. The new legislation introduces a gradual (linear) reduction in the benefit amount instead of this abrupt cut-off.

This article therefore focuses on analysing the impacts of removing the benefit cliff in the child allowance scheme, both in terms of labour market incentives for individuals and households and in terms of the effects on the state budget. It draws on available microdata for the years 2022 and 2023, modelling a scenario in which the current sudden loss of entitlement is replaced by a gradual reduction in the benefit amount.

II. Theory and Methodology

Over the past fifty years, developed countries have gradually shifted from direct social support paid in cash to support provided in the form of in-kind benefits and tax relief. However, this shift has also led to a weakening of protection for the most vulnerable groups of the population. In the last three decades, an approach aimed at motivating individuals to seek and retain employment has become increasingly prevalent.

An example of this is the adoption of the federal Personal Responsibility and Work Opportunity Reconciliation Act in the United States in 1996. This Act replaced the existing Aid to Families with Dependent Children (AFDC) program with a new program, Temporary Assistance for Needy Families (TANF), thereby shifting social security policy from an entitlement-based system to time-limited benefits linked to work activity requirements. While part of the professional community praised the new legislation for its activation-oriented approach, other experts criticized it for distorting the social system and being insufficiently effective for disadvantaged population groups. Notable works highlighting problematic aspects of the Act introduced under President Bill Clinton's administration include Edelman (2001), Thomas (2001), Piven (2001), and Munger (2003). Critical

reactions were significant and included concerns about “the end of social protection in the United States”, “increased poverty”, “reduced income for single mothers”, and “a rise in homelessness”. From a labour market perspective, some authors warned of the creation of a “virtually indentured labour force”. The effects of this reform were evaluated even two decades later, for example, in the work of Moffitt et al. (2015).

Similar experiences can be found in other developed countries, where social system reforms often led to the emergence or expansion of so-called benefit cliffs. This development triggered an extensive expert debate on how to set the interaction between earned income and social benefits for the economically weakest households in a fair, efficient, and sensitive manner. Consequently, numerous studies have emerged focusing on the optimization of social systems.

Some of these studies have examined the negative consequences of benefit cliffs, which in many cases became more pronounced. One frequently mentioned phenomenon is the deepening of poverty. For example, Caminada et al. (2021) found that, on average across 49 countries, 15 percent of the total population is lifted out of poverty via tax/benefit systems. As far as specific social programs are concerned, only three programs account for the bulk of total poverty reduction: old-age/disability/survivor schemes (81%), social programs for families and children (14%), and unemployment schemes (8%).

Another significant problem consists of information asymmetries and administrative barriers in claiming social benefits, as noted, for example, by Blanco and Vargas (2014). Equally important is the phenomenon referred to as non-take-up (incomplete take-up rates of social benefits), the scope of which is difficult to estimate precisely. Ko and Moffitt (2022) point out that, across different cultures, nations, and countries, take-up rates and the reasons for their levels vary; however, certain common features and universally applicable factors can be identified across these differences. The importance of the non-take-up issue for the effectiveness of social protection, as well as its impact on the state’s ability to provide effective assistance to populations in difficult life situations, is also emphasized by Bhargava and Manoli (2015) and Werner and Tur-Sinai (2024). Although non-take-up significantly affects the final structure of state budget expenditures, this issue is not the subject of the present article.

Research specifically addressing the problem of benefit cliffs includes, for example, Doolan and Kean (2023), whose main conclusion confirms that if benefit entitlements and other supports are withdrawn sharply as income rises, there may be a financial disincentive to enter employment or to work more. The same is true for tax and social insurance liabilities – if these jump at certain points or increase sharply, they may disincentivise employment. Prowse (2025), in his empirical study using a microsimulation model, finds that increasing the Universal Credit standard allowance proves more effective at reducing inequality than lowering the taper rate, as it provides more targeted support to low-income households. A second important finding is that fiscal drag – a form of stealth taxation that arises when inflation is not accompanied by corresponding increases in tax thresholds – is shown to be a substantially less equitable method of raising revenue than adjusting tax rates, since it imposes regressive effects, particularly on individuals near tax thresholds.

The issue of benefit cliffs is thus the subject of interest not only for theoretical and empirical studies, but also for analytical work by think tanks and other organizations that propose reform measures aimed at eliminating benefit cliffs from tax and social systems.

The following section focuses on the problem of benefit cliffs in the Czech context. The child allowance is a social benefit falling under the second pillar of social security – state social support – and is subject to a means test. Its amount varies according to the age category of the child (see Table 1).

Table 1: Child Allowance Amounts in 2022–2023 (in CZK)

	2022	2023
Up to 6 years	630	830
From 6 to 15 years	770	970
From 15 to max. 26 years	880	1080
Increased amount	500	500

Source: Act. No. 117/1995

Between 2022 and 2023, the amount of the child allowance increased by CZK 200. The threshold determining eligibility for the benefit remained unchanged in both monitored years, at 3.40 times the family's subsistence minimum. Exceeding this threshold results in a complete loss of entitlement to the allowance, while remaining below it enables the household to receive the full amount of the child allowance. Since 1 January 2018, the system has included a motivational component, to which a household becomes entitled if it achieves earned income. Initially, this increased amount was CZK 300, and in 2021 it was raised to CZK 500.

The proposed elimination of the benefit cliff is based on a linear principle. Households whose decisive income does not reach three times the family's subsistence minimum would be entitled to the child allowance in full. If the household's decisive income falls within the interval between three and four times the subsistence minimum, the amount of the allowance would decrease linearly. Upon reaching the upper limit of the interval (4.0 times the subsistence minimum), the allowance would fall to zero. The following section presents the formal mathematical expression of these conditions for calculating the child allowance:

$$D(Y) = \begin{cases} D_{\max}, & \text{if } Y \leq Y_{\min} \\ D_{\max} \cdot \left(1 - \frac{Y - Y_{\min}}{Y_{\max} - Y_{\min}}\right), & \text{if } Y_{\min} < Y < Y_{\max} \\ 0, & \text{if } Y \geq Y_{\max} \end{cases} \quad (1)$$

where $D(Y)$ denotes the amount of the child allowance, $D_{\max}$ represents the maximum possible benefit amount (full entitlement), Y denotes the net household income, $Y_{\min}$ is the threshold below which the household is entitled to the full allowance, and $Y_{\max}$ represents the threshold above which the entitlement ceases (the benefit equals zero).

For households with an income ranging from three times the subsistence minimum up to 3.4 times the subsistence minimum, the child allowance is reduced. Conversely, individuals with an income above 3.4 times the subsistence minimum will now become eligible for the allowance up to the level of four times the subsistence minimum. Data on the child allowance cover only incomes up to 3.4 times the subsistence minimum, whereas benefit amounts above this threshold are supplemented by data on the housing allowance.

Before carrying out calculations on real data, it is appropriate to illustrate how the cliff effect will be removed.

For the analysis of the (de)incentive effect of the child allowance on labour supply, the METR(EP) indicator (Marginal Effective Tax Rate for Employed Persons) was used. Its formula is as follows:

$$METR(EP) = 1 - \frac{\Delta NEI}{\Delta GEI} = \frac{\Delta IT + \Delta SSC_{EE} - \Delta PB - \Delta PD - \Delta SP - \Delta SA}{\Delta GEI} \quad (2)$$

where METR(EP) denotes the marginal effective tax rate for employed persons, ΔNEI refers to the change in net earned income, and ΔGEI refers to the change in gross earned income. IT stands for personal income taxes, SSC_{EE} for social security contributions paid by employees, PB for housing allowance, PD for child benefits, SP for other social benefits, and SA for benefits provided due to social need. GEI denotes gross earned wage.

If the marginal effective tax rate exceeds the value of 1, it reflects a situation in which an individual's net income decreases despite an increase in gross earnings. In such a case, working more becomes economically irrational. The individual falls into a "poverty trap" – a situation in which it is not possible to improve one's financial position, thereby discouraging work effort and reducing the incentive to participate actively in the labour market. The removal of the benefit cliff is simulated for two types of complete households with one and two children in 2022 and 2023. The first type is a four-member household (1 + 1 + 2) – a household with two adults (one employed) and two children – residing in Prague. At the benefit cliff, the child allowance for two children amounts to CZK 2,940 per month. The second type is a three-member household (1 + 1 + 1) – a household with two adults (one employed) and one child – receiving CZK 1,470 per month at the benefit cliff.

In both cases, these are complete families, which allows the assumption that one of the adults may increase their labour supply while the other provides childcare. Scenarios involving single-parent households would require addressing additional complexities, such as the type of employment compatible with childcare responsibilities. It cannot be ruled out that, in a complete household, both adults could work part-time; the presented examples therefore represent model scenarios only.

The simulation covers benefits provided under the State Social Support system (child allowance, housing allowance) and social assistance (subsistence allowance and housing supplement within the material need scheme). The first household is located in Prague, while the second is situated in an area classified in the second-lowest category by municipality size. Between 2022 and 2023, the categorisation changed: in 2022, there were five groups, with Prague as a separate category and the second-lowest defined as municipalities with 10,000–49,999 inhabitants (Pop 10k–50k). In 2023, the categories were reduced to

three: Prague was merged with Brno, and the second-lowest category was redefined as “municipalities with at least 70,000 inhabitants” (Pop 70k+). This reclassification was accompanied by an increase in normative housing costs.

Another significant adjustment between 2022 and 2023 was the increase in the amounts of the subsistence minimum, which translated into higher absolute values of social benefits derived from its statutory multiples (3.0; 3.4; 4.0). As a result of the concurrent adjustments to normative housing costs and the increase in the subsistence minimum, the resulting benefit amounts in 2023 are higher than the corresponding values in 2022.

The METR(EP) indicator makes it possible to assess the impact both on individuals and on entire households. Equally important, however, is to evaluate the implications for public finances. Although the proposed reform is not required to generate a net fiscal surplus, it must not significantly deepen the budget deficit. The anticipated benefit lies in higher labour market participation resulting from the removal of the fear that increasing earnings will lead to a sudden loss of benefits. This could also have a positive effect on the revenue side of the state budget through higher collection of personal income tax and social and health insurance contributions. Direct estimates of revenue impacts, however, are beyond the scope of this article.

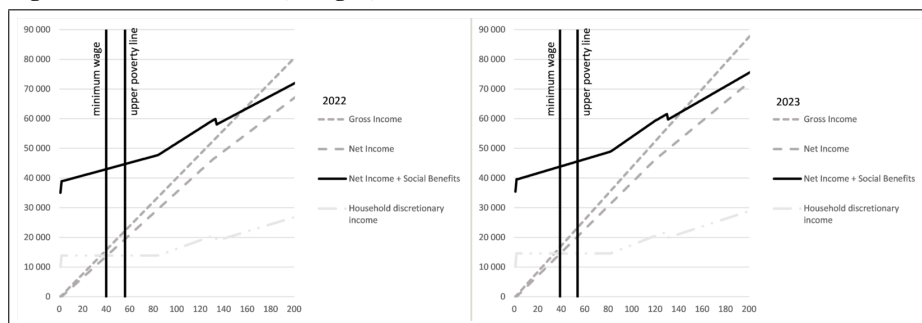
The analysis draws on administrative datasets provided by the Ministry of Labour and Social Affairs of the Czech Republic, which are used to project the effects of eliminating the benefit cliff. The data sources include information on the child allowance and housing allowance for November in 2022 and 2023. A typical limitation of administrative data is the presence of common deficiencies, particularly inaccuracies and missing records.

In total, the dataset contains 390,837 household records with at least one child (195,790 in 2022 and 195,047 in 2023). For 41,344 households, either the child allowance amount or the reference income is missing. Based on imputations from other variables, the number of such cases was reduced to 7,045, for which it is not possible to calculate or retrospectively verify the awarded benefit amount.

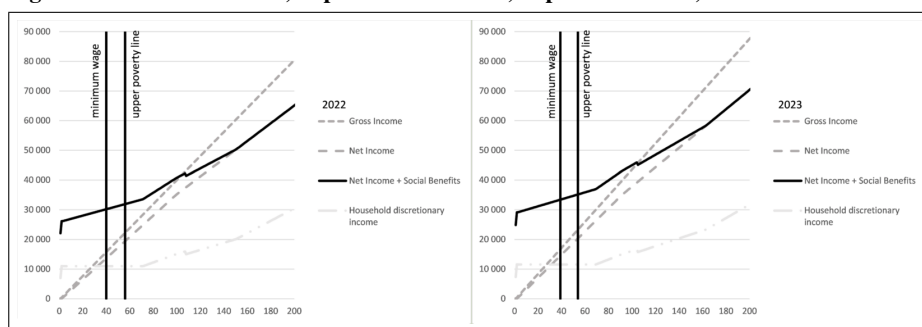
The impact on the state budget was assessed using standard microsimulation calculations. A limitation is that the data refer only to one month (November). The annual value of the child allowance is therefore estimated by a simple multiplication, although it cannot be stated with certainty that November is fully representative of the average monthly situation, even though this is a relatively stable benefit.

III. Results

This chapter presents the results in the following order. First, graphical outputs are introduced. The initial graphs depict the functioning of the child allowance under the current legislative framework. Subsequently, a model example is shown, in which the cliff effect is removed through a linear reduction of the allowance amount. Both systems are also illustrated using the METR(EP) indicator. After explaining the effects of removing the cliff effect on different household types, the chapter presents tabulated outputs estimating the fiscal impact of this adjustment on the state budget. The first two graphs illustrate the operation of the benefit system under the current legislation for the years 2022 and 2023.

Figure 1: Household 1+1+2, Prague, baseline

Source: Act. No. 117/1995, Act. No. 111/2006, own calculations

Figure 2: Household 1+1+1, Pop 10k–50k in 2022, Pop 70k+ in 2023, baseline

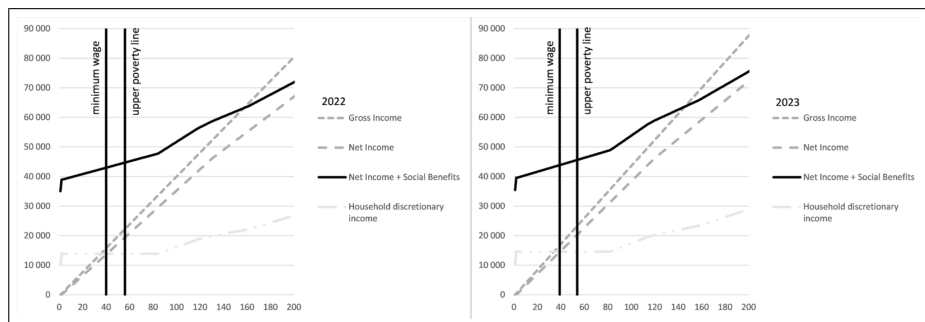
Source: Act. No. 117/1995, Act. No. 111/2006, own calculations

During the reference period, the benefit cliff for a four-member household residing in Prague was positioned at approximately 130% of the average gross wage, while for a three-member household it stood at roughly 105% of the average gross wage. In both years, 66% of employees earned less than the average gross wage. From a certain perspective, this issue might therefore be viewed as marginal. However, it is important to emphasise that the analysis focuses on only two specific household types, and it would not be reasonable to draw quick conclusions based on the results for these two model households alone. Nevertheless, removing the benefit cliff from the social benefit system is unlikely to bring a significant improvement in the situation of low-income households. For other household types, the cliff may be located much closer to the income poverty threshold.

On the positive side, even under the current legislation in 2022 and 2023, the benefit cliff was positioned above the poverty threshold. The poverty line is defined as 60% of the national median equivalised disposable income per person. In the past, there were situations in the Czech Republic where the cliff fell between the minimum wage and the upper poverty line. Such a situation no longer threatens, as both the coefficient multiplying the subsistence minimum and the absolute amounts of the subsistence minimum have been gradually increased.

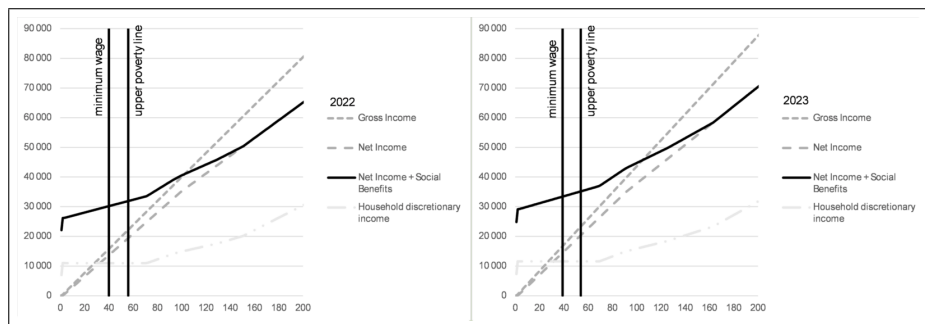
The benefit cliff has a disincentive effect not only at the exact threshold but also in its broader vicinity. Even the fear of a potential loss of social benefits can act as a deterrent for recipients. For families with children, the amount of the child allowance represents a non-negligible sum; therefore, households operating within a system that contains a cliff effect tend to behave differently than in one without it. According to the theory outlined above, such households display greater caution and lower labour market activity. The following two graphs illustrate the functioning of the system without a benefit cliff.

Figure 3: Household 1+1+2, Prague, reform



Source: Act. No. 117/1995, Act. No. 111/2006, own calculations

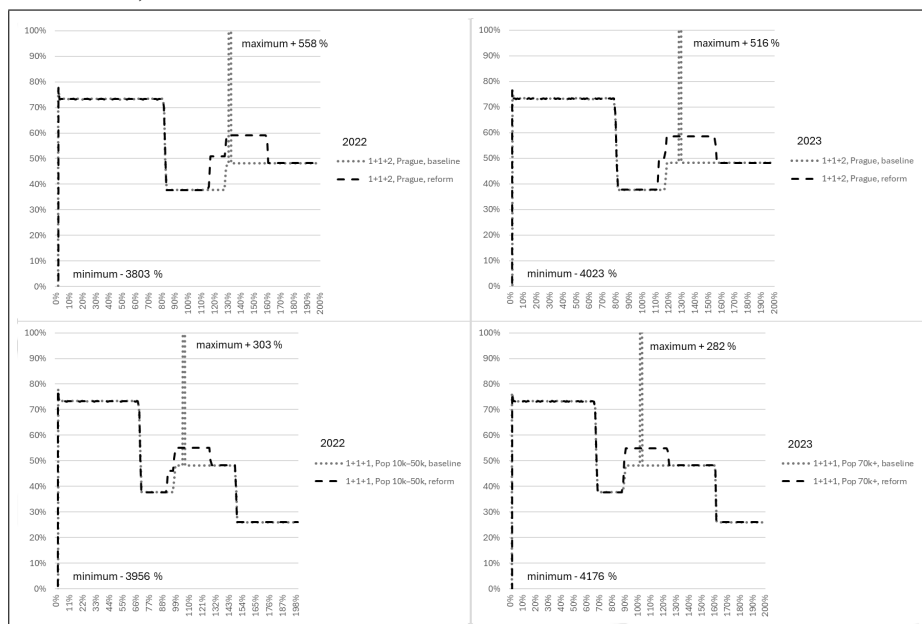
Figure 4: Household 1+1+1, Pop 10k–50k in 2022, Pop 70k+ in 2023, reform



Source: Act. No. 117/1995, Act. No. 111/2006, own calculations

Figures 3 and 4 show that the removal of the cliff effect has resulted in a smooth connection between the “Net Income + Social Benefits” curve and the “Net Income” curve. This intervention eliminates the sudden drop in disposable income and can thus positively influence households’ economic decision-making. In particular, for an economically active household member, removing the cliff effect means eliminating an objective barrier when considering the offer of increased working hours or negotiating a higher wage. The benefit of this adjustment is illustrated by the METR(EP) indicator. Values exceeding 1 (100%) represent situations in which the household loses more financial resources due to the tax-benefit system than it gains from an increase in earned income.

Figure 5: METR(EP), Household 1+1+2, Prague, Household 1+1+1, Pop 10k–50k in 2022, Pop 70k+ in 2023, baseline and reform



Source: Act. No. 117/1995, Act. No. 111/2006, own calculations

The analysis shows that the cliff effect in child allowance reached exceptionally high values – expressed in several hundred percent – in both examined years and for both model households. For the four-member household, the METR(EP) fell from values exceeding 500% to 59%, while for the three-member household it decreased from approximately 300% to 55%. Although these results still do not correspond to an ideal state, it is clear that the disincentive effect on labour activity has been significantly weakened. Further reductions in the METR(EP) values could be achieved by adjusting the parameters of the relevant income band (e.g., by shifting or widening it) or by modifying other systemic elements, particularly mandatory payroll contributions.

The analysis also revealed substantial differences between a household living in Prague and one in a municipality with a smaller population. In the first case, the METR(EP) reaches 48%, whereas in the second it falls to 26%. Although this is a significant difference, the issue is not explored further in this study. The key finding remains that, after the removal of the cliff effect, labour activity becomes financially advantageous, as the net income from employment exceeds the loss caused by the reduction in social benefits.

For a complete assessment of the impacts, it is, however, necessary to take into account the actual effects of the cliff effect removal on households receiving the child allowance and housing allowance. The following table presents the results of calculations based on data provided by the Ministry of Labour and Social Affairs of the Czech Republic.

Table 2: Household Quintiles by Eligible Income and Eligible Income-to-Subsistence Minimum Ratio, 2022–2023

Year/ Quintile	Eligible income (in CZK)				Eligible income / subsistence minimum			
	Min	Max	Mean	Relative position of the mean	Min	Max	Mean	Relative position of the mean
2022/1	0	7 220	2 386	0,330	0,000	0,653	0,220	0,338
2022/2	7 221	15 743	11 323	0,481	0,654	1,496	1,096	0,524
2022/3	15 744	23 517	19 667	0,505	1,497	2,128	1,820	0,513
2022/4	23 518	32 524	27 816	0,477	2,129	2,697	2,413	0,500
2022/5	32 525	96 981	40 255	0,120	2,698	6,287	3,064	0,102
2023/1	0	7 920	2 670	0,337	0,000	0,685	0,236	0,345
2023/2	7 921	17 729	12 659	0,483	0,686	1,574	1,158	0,531
2023/3	17 730	25 804	21 788	0,503	1,575	2,234	1,920	0,524
2023/4	25 805	35 280	30 286	0,473	2,235	2,815	2,529	0,506
2023/5	35 281	101 241	43 593	0,126	2,816	14,479	3,298	0,041

Source: MoLSA, own calculations

The table presents the thresholds of the decisive income and the ratio of decisive income to the subsistence minimum for individual household quintiles in 2022 and 2023. For both examined variables and in both years, the linear reduction in the amount of child allowance occurs only in the fifth quintile of households. This can be seen positively in that the benefit reduction affects only the 20% of households with the highest incomes. Nevertheless, it remains true that households with a coefficient between 3.0 and 3.4 already experience a reduction in the benefit. At the same time, this means that 80% of households have an income lower than three times the subsistence minimum.

The “relative position of the mean” column provides further context. The resulting value ranges from 0 to 1, where a value close to 0 indicates proximity to the lower bound of the interval, a value close to 1 indicates proximity to the upper bound, and a value of 0.5 indicates the midpoint. The values for decisive income and its ratio to the subsistence minimum differ slightly, with the fifth quintile’s value being closer to the lower bound.

This result has significance for predicting the behaviour of the microsimulation model. Based on the given data, it can be assumed that the introduction of a linear reduction in the child allowance will be budget-neutral for the state, or may lead to a slight increase in expenditure. The reason is that for the first four quintiles, the costs remain unchanged compared to the system with the cliff effect, whereas in the fifth quintile, a slight increase in expenditure can be expected. Most real households in this group are positioned closer to the lower bound of the interval: households with a coefficient up to 3.4 will receive a slightly lower benefit in absolute terms than before, while households above this value will newly become eligible for the child allowance, which will be gradually reduced through the linear

mechanism. Most households entitled to the benefit are concentrated around a coefficient value of 3, while only a small number of newly eligible households have been added, and their benefit amount is significantly lower.

The results of the microsimulation model are summarised in the following tables. The first two present the number of households in 2022 and 2023 with income below three times the subsistence minimum and the number of households with income above this threshold.

Table 3: Number of Households with Income Below and Above Three Times the Subsistence Minimum in 2022 and 2023 (in CZK)

2022	Number of Households		
	Below 3x	Above 3x	Total
Basic rate	49 336	19 645	68 981
Increased rate	111 317	15 492	126 809
Total	160 653	35 137	195 790

2023	Number of Households		
	Below 3x	Above 3x	Total
Basic rate	53 819	11 321	65 140
Increased rate	112 655	17 252	129 907
Total	166 474	28 573	195 047

Source: MoLSA, own calculations

In the November data, a difference is evident between the monitored years in the number of households falling below the threshold of three times the subsistence minimum and those above this threshold. This difference is primarily attributable to the increase in the amounts of the subsistence minimum for individual household members, and consequently to the subsistence minimum of the household as a whole. As a result of this adjustment, higher total expenditures from the state budget on the child allowance can be expected in 2023 compared to 2022.

The total expenditures on the child allowance in 2022 and 2023, calculated both according to the applicable legislation and under the application of linear reduction, are presented in the following table.

Table 4: State Budget Expenditures on Child Allowance in November 2022 and 2023: Comparison between Current Legislation and Linear Tapering Scenario (in CZK)

	Current Legislation	Linear Tapering Scenario	Difference
2022	380 734 363	376 752 420	+3 981 943
2023	459 775 433	462 465 829	−2 690 396

Source: MoLSA, own calculations

The table is based on data from the Ministry of Labour and Social Affairs of the Czech Republic. The November values for child allowance expenditures indicate that the measure is largely budget-neutral. In November 2022, the measure would have resulted in a slight saving for the state budget, whereas in November 2023, it would have led to a slight increase in expenditures.

The following table presents both the official statistics on state budget expenditures for child allowance and the estimated expenditures after the removal of the cliff effect, calculated on the basis of the available data.

Table 5: Official Statistics and Imputed Annual Estimates of the Impact of Removing the Benefit Cliff (in CZK)

	Current Legislation	Linear Tapering Scenario	Difference
2022	3 870 763 897	3 830 281 181	+40 482 716
2023	5 513 713 367	5 545 977 101	–32 263 734

Source: MoLSA, own calculations

The annual results show that the measure aimed at removing the cliff effect is essentially budget-neutral. In this table, the original values from the database were replaced with official statistics on state budget expenditures for child allowance in the given year. In 2022, the difference was positive; however, compared to actual expenditures, it represented a slight decrease of 1%. Conversely, in 2023, the difference was negative; however, relative to actual expenditures, it corresponded to a slight increase of 0.6%. This outcome confirms that the chosen approach can be considered fiscally sustainable and, at the same time, a tool that can be implemented without the need for extensive compensatory measures in other areas of public spending.

The linear taper applied in this study does not represent the only possible solution; there are numerous parametric options for removing the cliff effect. For instance, the lower or upper threshold of the linear taper could be shifted to a lower (e.g., between 2 and 3) or higher level (e.g., between 4 and 5), the range of the taper could be widened (e.g., between 2 and 4) or narrowed (e.g., between 3 and 3.5), or a non-linear form of reduction could be chosen, such as a logarithmic taper. Such parametric adjustments would have different impacts on individual households. The values of the METR(EP) indicator would vary, and the effect on the state budget would also change. By adjusting the parameters, various outcomes could be achieved, such as strengthening or weakening support for families through child allowance, or accelerating or slowing the rate of benefit reduction. It cannot be ruled out that specific parameter settings might align with the prevailing political ideology. In all cases, however, it would be advisable to conduct a comparable analytical study to the one presented in this article.

IV. Conclusion

The elimination of the cliff effect is essential from the perspective of both efficiency and equity of the social system, as it removes situations in which social benefit recipients face disproportionately high marginal tax rates on their additional income. This generally ensures that the financial incentive to work or to increase work effort remains intact even for low-income population groups. The introduction of parameters that reduce the negative impacts of this phenomenon thus represents not only a technical measure to improve system performance, but also an important step toward enhancing its social fairness and long-term sustainability. In the broader context of social policy, eliminating the cliff effect contributes to greater predictability and stability of household incomes, thereby increasing their ability to plan and carry out long-term economic activities.

From a macroeconomic perspective, the removal of the cliff effect may also contribute to higher levels of economic activity and consumption, as more stable household incomes reduce the need to maintain excessive liquid reserves and enable a faster return of funds into circulation. This effect can be amplified during periods of economic slowdown, when the importance of targeted stabilisation tools increases.

The analysis has shown that eliminating the cliff effect in the child allowance system has the potential to significantly reduce the disincentive effects on work activity without imposing a substantial burden on the state budget. Simulations on model households confirmed that the proposed parameters of a linear taper led to a substantial reduction in extremely high METR(EP) values, which in the original setting reached several hundred percent. After implementing the linear taper, METR(EP) values fall to levels that can be considered much more favourable in terms of incentives to engage in work. Individuals and households no longer need to fear losing financial resources as a result of increasing their work activity or negotiating higher pay. This effect is particularly important for households located just above the original cliff point, which previously experienced the steepest declines in net income following small increases in gross income.

The positive impact of this measure can also be interpreted from the perspective of social cohesion, as it removes perceived injustices and reduces the risk of social exclusion for groups that were previously disproportionately penalised for modest income growth. In this way, it contributes to the stability of the social environment and strengthens public trust in the institutional framework of social policy.

The results on both a monthly and annual basis indicate that the impact on the state budget is essentially fiscally neutral, with differences between 2022 and 2023 being driven primarily by increases in subsistence minimum amounts and adjustments to housing cost norms. These changes resulted in higher absolute amounts of social benefits, which in turn affected total expenditure. The analysis showed that in 2022 the measure would have resulted in a slight saving (1%), while in 2023 it would have led to a slight increase in expenditure (0.6%). This outcome confirms that the chosen approach can be considered fiscally sustainable and a tool that can be implemented without the need for extensive compensatory measures in other areas of public expenditure.

The selected linear taper model represents one possible option for eliminating the cliff effect. Parametric adjustments – whether in the form of changing the boundaries of the taper range, widening or narrowing it, or selecting an alternative taper shape – can lead to different impacts on both households and the state budget. The choice of specific settings is always a political decision; however, from a public policy design perspective, it is desirable that any adjustment be supported by a comprehensive empirical analysis of the type presented in this article. This ensures that measures are not only technically effective but also socially acceptable, and that their implementation leads to a long-term strengthening of the balance between economic efficiency and social protection.

Acknowledgements

This research output was supported financially via institutional support for the long-term conceptual development of research organisations for the period 2023–2027 and forms part of research task “Tipping points in uninsured benefit systems” (No. 70204) addressed by the Research Institute for Labour and Social Affairs in the period 2023–2025.

References

- Bhargava, S., Manoli, D. (2015). Psychological frictions and the incomplete take-up of social benefits: Evidence from an IRS field experiment. *American Economic Review*, 105(11), 3489–3529.
- Blanco, M., Vargas, J. F. (2014). Can SMS technology improve low take-up of social benefits? *Peace Economics, Peace Science and Public Policy*, 20(1), 61–81.
- Caminada, K. et al. (2021). Antipoverty Effects of Various Social Transfers and Income Taxes Across Countries. *Social Indicators Research: An International and Interdisciplinary Journal for Quality-of-Life Measurement*, 154(3), 1055–1076.
- Doolan, M., Keane, C. (2023). Cliff edges in the Irish tax-benefit system. *Economic and Social Research Institute Budget Perspectives*, 2024(1), 1–39.
- Edelman, P. B. (2001). Poverty & welfare: Does compassionate conservatism have a heart? *Albany Law Review*, 64(3), 1073–1083.
- Ko, W., Moffitt, R. A. (2022). Take-Up of Social Benefits. National Bureau of Economic Research. *NBER Working Paper* No. w30148.
- Moffitt, R. et al. (2015). Welfare Rules, Incentives, and Family Structure. *Journal of Human Resources*, 55(1), 1–42.
- Munger, F. W. (2003). Poverty, welfare, and the affirmative state. *Law & Society Review*, 37(3), 659–686.
- Piven, F. F. (2000). The Link between Welfare Reform and the Labor Market. *University of Pennsylvania Journal of Law & Social Change*, 5(1), 1–20.
- Prowse, V. (2025). Programme interactions and fiscal drag in the UK tax-and-benefit system: effects on income inequality. *Oxford Review of Economic Policy*, 41(1), 140–152.
- Thomas, S. L. (2001). “Ending Welfare as We Know It,” or Farewell to the Rights of Women

on Welfare? A Constitutional and Human Rights Analysis of the Personal Responsibility Act. *University of Detroit Mercy Law Review*, 78(2), 179–202.

Werner, P., Tur Sinai, A. (2024). Israeli adults' non take up of social benefits: A study using the socio ecological model. *Journal of Social Service Research*, 50(2), 1–17.

Czech legislation: Act No. 117/1995 Coll., on State Social Support